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No. 93-1132

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1993

REUTERS LIMITED,

Petitioner,

against

TAX APPEALS TRIBUNAL and COMMISSIONER OF TAXATION AND FINANCE,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF OF RESPONDENT COMMISSIONER OF TAXATION AND FINANCE IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Counterstatement of Questions Presented

1. Whether this Court should grant certiorari to review a decision of the New York Court of Appeals that New York's use of the allocated worldwide income of a British corporation doing business in New York through a branch as the basis for calculating the corporation's corporate franchise tax does not violate the nondiscrimination provision of the United States-United Kingdom tax treaty, when the plain language of the treaty envisions such an approach, the legislative history indicates it had the express approval of the Senate and the Executive Branch, and the resulting tax is no greater than that imposed on a non-New York United States corporation with a New York branch.

2. Whether this Court should grant certiorari to review the conclusion of the New York Court of Appeals that the petitioner, which has complied with the essentially unchanged requirements of the New York Franchise Tax Law continuously since 1917, had made an insufficient showing that its supposed costs of "start up" for and "adjustment" to this tax law more than sixty years later were so burdensome as compared to the compliance costs of a non-New York United States corporation with a New York branch that both the nondiscrimination provision of the United States-United Kingdom income tax treaty and the Foreign Commerce Clause of the Constitution were violated.

3. Whether this Court should grant certiorari in order to resolve a supposed conflict between its decision in *Kraft General Foods, Inc. v Iowa Department of Revenue and Finance*, ____ US ____, 112 S Ct 2365 (1992), which holds that the Foreign Commerce Clause prohibits a State from imposing a burden on foreign subsidiaries of domestic corporations that it does not impose on domestic subsidiaries of the same corporations, and the decision of the New York Court of Appeals that, as originally held by this Court in 1924, New York's calculation of corporate franchise tax in exactly the same fashion for foreign and for non-New York domestic corporations with New York branches does not discriminate unconstitutionally against foreign commerce.

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No. 93-1132

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OCTOBER TERM, 1993.

REUTERS LIMITED,

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BRIEF OF RESPONDENT COMMISSIONER OF TAXATION AND FINANCE IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Statement of the Case

For the privilege of doing business in New York State, the State has since 1917 imposed on every domestic and foreign corporation a corporate franchise tax. NY Tax L § 209(1)

(McKinney 1986); *see*, 1917 NY Laws ch 726. The tax is calculated on the basis of a corporation's "entire net income," which is defined as "total net income from all sources, which shall be presumably the same as the entire taxable income which the taxpayer is required to report to the United States treasury department." *Id.* § 208(9). Entire net income includes "income within and without the United States." *Id.* § 208(9)(c). For an "alien corporation"—that is, "[a] corporation organized under the laws of a country other than the United States which has income from sources outside the United States," 20 NYCRR § 3-8.3 (1984)—the basis upon which the New York franchise tax is calculated includes worldwide income. For most purposes "[e]very corporation is a separate taxable entity and shall file its own report." 20 NYCRR § 6-2.1(a) (1984). Thus, for example, the income of subsidiary or affiliated corporations of alien corporations doing business in New York is not included in the alien corporation's entire net income.

When an alien corporation does business both in New York and elsewhere, New York allocates a portion of its entire net income to the State according to a commonly-employed three-factor formula. The value of the corporation's real and tangible property, payroll and receipts in New York is compared to the worldwide value of these factors to produce a ratio called a "business allocation percentage." NY Tax L § 210(3) (McKinney 1986). The corporation's worldwide entire net income is then multiplied by this percentage to produce the portion of income allocated to the State. *Id.* The franchise tax is a fixed percentage of this allocated income. *Id.* § 210(1)(a). This basic approach to the franchise tax on foreign corporations—allocating a portion of their net income to New York according to a formula designed to produce an estimate of the ratio a corporation's New York assets bears to its total assets—has gone unchanged since the franchise tax began. *See*, 1917 NY Laws ch 726, § 214.

Petitioner Reuters Limited ("Reuters") is a corporation organized and existing pursuant to the laws of the United Kingdom with a principal place of business in London (R7).[1] It is engaged in the business of supplying news and economic and financial information by electronic means to newspapers, banks and other interested entities (R7). Reuters has been doing business in New York since 1916 (R265). From that time at least through the taxable years at issue in the present case, Reuters conducted its overseas operations, including those in New York, through branches—that is, offices of the main corporation without an independent jural or corporate identity (R129). Thus, for some sixty years prior to 1977, Reuters apparently paid New York franchise tax calculated on the basis of what is now called its business allocation percentage. During the years 1977 through 1979, Reuters did business in approximately 80 countries worldwide (R7). During these years, Reuters maintained a branch office in New York City, which served as its main office in the United States (R8).

For the 1977 tax year, the accounting firm of Coopers and Lybrand prepared and timely filed for Reuters a Franchise Tax return that calculated the tax according to the statutory scheme that Reuters had presumably followed for the previous sixty years, reporting Reuters' worldwide entire net income and multiplying it by a business allocation percentage of approximately nine percent, representing the proportion of Reuters' New York property, payroll and receipts to its worldwide holdings (R230-245). For 1978 and 1979, however, Reuters' franchise tax returns departed from the correct approach, instead treating as entire net income only Reuters' income from United States sources (R256-273). Because Reuters claimed a loss on its United States operations, it paid no tax for these years. Reuters subsequently filed an amended return for 1977, similarly treating as

[1]Parenthetical citations preceded by "R" are to the Record on Appeal in the New York Court of Appeals. Parenthetical citations followed by "a" are to the Appendix to the Petition.

entire net income only income from United States sources, declaring a loss on its United States operations for the year, and claiming a refund on the tax it had paid (R247-254).

Beginning in 1980, the Audit Division of the New York State Department of Taxation and Finance performed a field audit of Reuters' books and records (R274-277). Because Reuters had been incorrectly calculating its tax liability on the basis of United States income only, the Audit Division recalculated the franchise tax due. For 1977, it relied on the figures from Reuters' original return (R275). For 1978 and 1979, however, Reuters refused to provide the Audit Division with figures on its worldwide operation (R275-276). The Audit Division was thus forced to use Reuters' published annual reports as the source for its computations (R276). This resulted in the issuance to Reuters, on October 14, 1983, of three notices of deficiency, indicating additional tax due in the amounts of $1,333 for 1977, $598,596 for 1978, and $680,171 for 1979 (R184).

On November 7, 1985, representatives of Reuters conferred with Regina Jaffe of the New York State Tax Commission concerning the additional tax assessed (R279). Thirteen days later, Reuters provided Ms. Jaffe the requested data on its worldwide net income and its "allocable business income by reference to the aggregate of the percentages of New York as compared to worldwide property, sales and wages" (R279-280). On April 21, 1986, this resulted in a reduction of Reuters' additional franchise tax to the amounts of $973 (for 1977), $50,609 (for 1978), and $44,586 (for 1979) (R225-226).

On August 26, 1986, Reuters filed with the State Tax Commission an administrative petition for redetermination of the deficiencies or for a refund of the franchise tax (R202). This petition was amended on December 3, 1987 (R207). Reuters contended that New York's calculation of the franchise tax on the basis of Reuters' worldwide income violated the Foreign Commerce

Clause of the United States Constitution and the Nondiscrimination provision of the United States-United Kingdom Tax Treaty ("the Treaty"). Article 24(2) of the Treaty provides that

> [t]he taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities.[2]

On December 7, 1987, a hearing was held before an Administrative Law Judge ("ALJ"). The sole witness was Michael J. Canty ("Canty"), who is the head of Reuters' tax department (R128). Canty noted that the United Kingdom taxes Reuters, as it does other United Kingdom resident companies, on a worldwide basis, subjecting all Reuters activities anywhere in the world to United Kingdom tax (R130). He added that Reuters would receive tax credit from the United Kingdom for taxes paid to New York (R131). He indicated that he had "no idea" of what would be Reuters' costs "to put in . . . a system" of reporting that would comply with New York's franchise tax law (R135). Canty did not explain why, since Reuters had been complying with New York law for sixty years, any such system would have to be "put in" at all.

In an affidavit submitted to the ALJ some five months after the hearing, Canty estimated that Reuters would have "start-up cost[s]" of $86,000 to "modify the books of account of the Reuters operation" in order "to conform them . . . to New York corporation tax rules" (R295). He also estimated that Reuters' annual compliance costs would be $980,000 (R296). Again, Canty did not indicate why, if Reuters was calculating its New

[2]The Treaty provides that a "permanent establishment" is a "fixed place of business through which the business of an enterprise is wholly or partly carried on." Treaty Art. 5(1). A "branch" of a business is one type of permanent establishment. Treaty Art. 5(2).

York tax in approximately the same way it had for six decades, including 1977, its bookkeeping would require any "adjustments" or "modif[ications]" (R295), or incur any related costs to "start up" an operation it had begun in 1917.

On February 22, 1990, the ALJ issued a decision denying Reuters' petition and sustaining the notices of deficiency (35a). With respect to the constitutional issue, the ALJ relied on *Bass, Ratcliff and Grettan Ltd. v State Tax Commission*, 266 US 271 (1924), in which this Court upheld a challenge to New York's franchise tax by a British corporation which, like Reuters, objected to its worldwide income serving as the basis for New York's taxation of its branch in the State (46a-47a). The ALJ also rejected Reuters' claim that New York's approach violated the nondiscrimination clause of the Treaty, noting, *inter alia*, that both legislative and executive discussions of the Treaty expressly indicated that States in which branches of alien corporations do business may consider the worldwide income of those corporations in assessing tax, and that Reuters' original 1977 tax return and the speed with which Reuters provided worldwide information to the Tax Department "strongly suggest[ed] that its estimated costs of compliance are greatly exaggerated" and not the result of an unconstitutional burden on foreign commerce (52a-55a).

Reuters appealed the ALJ's determination to the New York Tax Appeals Tribunal ("the Tribunal"), which on March 21, 1991 issued a decision affirming the determination (18a). Dealing first with Reuters' Treaty argument, the Tribunal noted that the tax in question "is a corporation franchise tax," and the corporate taxpayer is not Reuters' New York branch but the corporation Reuters Limited (31a). The Treaty requirement that the franchise tax on Reuters be the same as that "on enterprises of [New York] carrying on the same activities" meant, said the Tribunal, that it must compare the taxation of Reuters with that of "a New York corporation with a New York office and worldwide branch activi-

ties." (31a). By this comparison, there is no discrimination, since the hypothetical New York corporation "would be taxed in the same manner as petitioner here, i.e., on the basis of apportioned worldwide income." (31a). In the Tribunal's view, "petitioner is really asking that it be treated more favorably than a New York corporation organized in the same manner as petitioner," for Reuters in effect seeks to have its branch treated as a corporate entity entirely distinct from the United Kingdom corporation of which it is a part (31a). The Tribunal, following the ALJ, also rejected Reuters' constitutional claim (33a-34a).

Reuters then commenced a proceeding pursuant to NY Tax L § 2016 in the Appellate Division, Third Department, which on June 11, 1992 issued an opinion and judgment confirming the Tribunal's determination and dismissing Reuters' petition (12a). The Appellate Division concluded that "the nondiscrimination clause requires a comparison . . . between the taxation of petitioner's United States branch located in New York and the taxation of a United States corporation having a branch in New York and conducting international business through branch offices in other countries" (14a). By this comparison, Reuters would pay "the very same tax" as would "a United States corporation 'carrying on the same activities' as [Reuters] with a New York branch and worldwide branch activities" (15a). After reviewing the legislative history of the treaty, the Appellate Division recognized that it "clearly manifests an intent . . . to allow the states the freedom to tax branches of a United Kingdom corporation on the basis of the corporation's worldwide income as allocated to each state" (15a). The court also rejected Reuters' constitutional arguments, noting that *Bass, Ratcliff* had resolved the central constitutional question decades before and expressing deep skepticism as to Reuters' claims of "prohibitively large" compliance costs, which it deemed "sorely undermined" by Reuters' conduct before the case commenced (16a).

On October 27, 1992, the New York Court of Appeals dismissed Reuters' purported appeal as of right "upon the ground that no substantial constitutional question is directly involved." On February 11, 1993, the New York Court of Appeals granted Reuters' motion for leave to appeal (R350). On October 12, 1993, that Court issued a unanimous decision affirming the judgment of the Appellate Division (1a). The court observed that Reuters' New York branch is "not juridically equivalent to a free-standing entity" such as a corporation (5a). Rather, "[t]he ultimate taxpayer here is the corporate entity," Reuters Limited, and not its branch, which cannot be regarded "as an enterprise discrete from its juridical parent" (6a). The court noted that the Treaty defines an "enterprise" as "an industrial or commercial undertaking carried on by a resident of a Contracting State," and in turn defines a "resident of a Contracting State" as a United States or United Kingdom corporation (6a). From this the court concluded that "the domestic subject of comparison under the Treaty is an industrial or commercial undertaking carried on by a United States corporation" (6a-7a). If such an "undertaking" is in fact a branch office of the corporation, then the branch and the corporation "are a single business enterprise for franchise tax purposes" (7a). The Court of Appeals thus accepted the Appellate Division's conclusion that the proper comparison, for purposes of the Treaty, is between New York's taxation of Reuters' branch and its hypothetical taxation of a branch of a United States corporation, and observed that this comparison "results in nondiscriminatory tax treatment" for Reuters (7a).

The court found its conclusion to be "buttresse[d]" by the legislative history of the Treaty, noting that both the Senate Foreign Relations Committee's Report on the Treaty and the Treasury Department's Technical Explanation contained express assurances that states could continue to impose corporate franchise tax on the branch offices of British corporations on the basis of the apportioned worldwide income of those corporations (7a-8a). Moreover, said the court, it "strains credulity" to imag-

ine, as Reuters' argument demands, that the antidiscrimination provision was intended "as an indirect curtailment on the open and widespread use of worldwide income apportionment," in which forty-five of the fifty states engage (8a).

The court finally turned to Reuters' constitutional argument, noting that *Bass, Ratcliff* had "rejected a Foreign Commerce Clause challenge to the validity of New York's apportionment methodology on similar facts," and had in turn "been reaffirmed by modern Supreme Court tax jurisprudence" (9a). The Court of Appeals added that it shared the Appellate Division's skepticism as to Reuters' extravagant claims about its compliance costs, declining to "speculate on" the legal validity of Reuters' argument because of Reuters' "failure" to make a "sufficient factual showing" (9a).

REASONS FOR DENYING THE WRIT

I.

As the Court of Appeals recognized, neither the Treaty's language, its legislative history nor its interpretation by the contracting states supports Reuters' position.

The New York Court of Appeals correctly observed that Reuters' reading of the nondiscrimination provision of the US-UK tax treaty "strains credulity and proper interpretation." The language of the provision instead supports the interpretation offered by respondent Commissioner of Taxation and Finance, while the legislative history of the Treaty and the model convention on which it is based demonstrate that the approach urged by Reuters is not merely implausible but flatly impossible. For good reason, two administrative tribunals and two New York courts have now reached this conclusion unequivocally and without dissent. There

is no reason to grant Reuters' petition merely to reach this inevitable result.

The relevant treaty provision, which unlike most of the Treaty applies to taxes "imposed by . . . political subdivision[s]" of the signatories, Treaty Art. 2(4),[3] and therefore to New York State, requires that

> [t]he taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. Treaty Art. 24(2).

According to petitioner, this provision requires on its face that New York's taxation of Reuters' branch (i.e. its "permanent establishment") in New York be no less favorable than the tax on New York corporations (i.e. "enterprises of that other State") which are "carrying on the same activities" as the branch. Because the branch is, by definition, conducting business only in New York, petitioner contends that its taxation must be compared not to that of a corporation with worldwide activity but to the tax imposed on a "local" corporation, doing business only in New York.

As the Court of Appeals noted, however, the nondiscrimination provision can most readily be interpreted as a recognition that the taxes in question are never imposed "on" a permanent establishment, but rather on the corporation of which it is a part and apart from which it has no separate jural identity. The provision simply reflects that taxation is imposed on "enterprises"—that is, corporations doing international business through their branches—and does not envision that these branches be viewed as independent entities at all. The Treaty defines an "enterprise" as "an indus-

[3]The US-UK Treaty is reprinted at 1980-1 C.B. 394 and at 31 U.S.T. 5668, and is cited hereinafter by Article and Section number.

trial or commercial undertaking carried on by a resident of a Contracting State." Treaty Art. 3(1)(d). A "resident of a Contracting State" is defined as either "a corporation whose business is managed and controlled in the United Kingdom" or "a United States corporation." Treaty Arts. 3(1)(i); 4(1)(a)(ii); 4(1)(b)(ii). Thus, as the Court of Appeals concluded, the comparison required by the nondiscrimination clause is between a United States corporation with a branch office in New York, viewed as a single business enterprise, and a British corporation with a branch office in New York, also regarded as a single enterprise. The Treaty recognizes that tax is imposed not on a branch or permanent establishment but on the corporation of which it is part—in other words, that Reuters' New York branch is not, as Reuters contends (Petition, p 12), "a separate entity." By the comparison mandated by the Treaty, Reuters has nothing to complain of, for it is being taxed by New York no more severely than a United States corporation with a New York branch would be.

Even if petitioner were correct in suggesting that the proper comparison under the nondiscrimination clause is between the branch of an alien corporation and a hypothetical New York corporation, it is unclear from the face of the provision alone whether that hypothetical corporation "carr[ies] on the same activities" as the branch or as the corporation of which the branch is a part. For obvious reasons, petitioner insists (Petition, p 12) that it is "clear" that the language refers to the local branch. But even a scholar who ultimately may share petitioner's interpretation finds that the provision presents "difficulties" and "problems" in interpretation arising from its "elliptical" and "ambigu[ous]" phrasing. *See*, Gifford, *Permanent Establishments Under the Nondiscrimination Clause in Income Tax Treaties*, 11 Cornell Int'l L.J. 51, 60, 61 (1978). When the text of a treaty is ambiguous, it is proper for courts to consult the treaty's legislative history in order to interpret it. *Chan v Korean Air Lines, Ltd.*, 490 US 122, 134 (1989). Indeed, even when treaty language is clear, this "obvious meaning" must be ignored when it " 'effects

a result inconsistent with the intent or expectations of the signatories.' " *Sumitomo Shoji America, Inc. v Avagliano*, 457 US 176, 180 (1982) (quoting *Maximov v United States*, 373 US 49, 54 [1963]). Both the history of this particular treaty and the commentary to the model convention on which it is based indicate that the nondiscrimination provision cannot possibly mean what petitioner would like it to.

The most compelling argument against petitioner's interpretation is based on both scholarship and common sense. New York is not the only state that imposes corporate tax on the basis of the allocated worldwide income of alien corporations with a branch in the state. As the Court of Appeals observed, every one of the forty-five states that impose any corporate tax on the basis of income looks beyond the income of a particular branch of a corporation located in the State to include the net income of the corporation's worldwide operations and calculates the tax by means of formula apportionment. *See*, 1992 State Tax Guide (CCH) ¶¶ 10-110, 10-115. Nor, as the cases of this Court upholding such taxation reveal, is this a new arrangement. Rather, states have been using formula apportionment to calculate corporate income and franchise tax for decades. *See, e.g., Bass, Ratcliff & Gretton v State Tax Commission*, 266 US 271 (1924) (sustaining New York's three-factor formula for allocating the profits of New York's branch of British corporation on the basis of corporation's worldwide income); *Underwood Typewriter Co. v Chamberlain*, 254 US 113 (1920) (sustaining validity of Connecticut corporate income tax imposed by apportioning total net income of Delaware corporation). If the treaty forbids New York from taxing in this fashion, it forbids these other states as well.

Moreover, as petitioner points out (Petition, p 13, n 13), the nondiscrimination provision of the US-UK treaty is based, like all modern U.S. income tax treaties, on the Model Double Taxation Convention on Income and on Capital of the Organization for Economic Cooperation and Development (1977) ("Model Con-

vention").[4] Many other United States treaties, including those with France and Japan, contain a nondiscrimination clause identical or indistinguishably similar to the provision at issue in this case. *See, e.g.*, United States-Japan Income Tax Convention, Art. 7(2), 1973-1 C.B. 630; United States-France Income Tax Convention, Art. 24(3), 1968-2 C.B. 691. If Reuters' reading of the US-UK treaty is correct, there is no reason its analysis would not apply to these other treaties as well. Petitioner can prevail only if this Court concludes that the Senate, by virtue of the nondiscrimination clause, imagined that it was depriving virtually all states of routinely-assessed corporate tax revenue derived from foreign corporations doing business in the United States and instead requiring the states to treat a corporate branch, with no individual legal identity, as if it were a subsidiary corporation dealing at arm's length with its parent.

Fortunately, there is overwhelming evidence in the legislative history of the Treaty to demonstrate that the Senate believed exactly the opposite: that states remained free to tax branches of British corporations on the basis of the corporations' worldwide income as allocated to each state. Article 9(4) of the Treaty, as it originally read, forbade states, in determining the tax liability of a British corporation, from "tak[ing] into account the income, deductions, receipts or outgoings of a related enterprise of the [United Kingdom] or of an enterprise of any third State related to an enterprise of the [United Kingdom]." This provision would, in other words, have prohibited so-called Worldwide Combined Reporting, whereby state franchise tax is calculated on the basis not only of the income of a foreign corporation doing business in the

[4]A new edition of the Model Convention and the accompanying Commentaries was published by the Organization for Economic Cooperation and Development in 1992. Because the scholarship on the Model Convention alluded to herein makes reference to the 1977 edition, references throughout this brief are to the 1977 edition. Where the 1992 edition differs from its predecessor in any pertinent respect, these differences are duly noted.

state but also of the income of the corporation's parent, subsidiary and related corporations engaged in a "unitary business" with the taxpayer, whether or not these related corporations themselves do business in the taxing state. The validity of this approach to taxation was at the time the US-UK Treaty was under consideration by the Senate and is today a vexed and changing issue. This Court has recently agreed to review certain aspects of worldwide combined reporting as practiced by California. *See*, *Barclays Bank v Franchise Tax Board*, 10 Cal App 4th 1742 (1992), *cert. granted*, ____ US ____, 114 S Ct 379 (1993).

New York, however, does not tax this way, so petitioner is correct to note (Petition, p 20) that the Senate's eventual refusal to ratify this provision as applied to states is irrelevant to New York taxation. What is relevant, however, is the pains taken in the course of the legislative history to demonstrate that the doomed provision, whether or not ratified, would have no effect on state taxation of the branch of a British corporation on the basis of worldwide income. Thus, in the initial hearings on the Treaty before the Senate Foreign Relations Committee, a speaker on behalf of the Confederation of British Industry[5] reassured the Committee that even under the proposed treaty, "California may continue to take into account all domestic and foreign income of a U.K. corporation doing business in California." Prepared Statement of John S. Nolan, Senate Foreign Relations Comm., 95th Cong. 1st Sess., Hearings on the Tax Convention with the United Kingdom of Great Britain and Northern Ireland ("Treaty Hearings") (1977) 193.

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[5]This organization purports to represent businesses which together employ approximately half of the British workforce and to speak for British business as a whole. The record does not indicate whether it numbers Reuters among its members and Reuters has not, in the course of the judicial proceedings herein, volunteered an answer to this question.

As the Court of Appeals noted, the pronouncements of both the Senate and the Executive on the proposed treaty were replete with assurances that states could continue to tax exactly as New York taxes Reuters. Thus, in the Senate Foreign Relations Committee's Report on the Treaty, it contrasted proposed Article 9(4) with the approach to taxation of corporate business income taken by New York:

> In most states this business income is apportioned between the state and other jurisdictions according to a basic three-factor formula. . . . This type of apportionment, when applied to a single business of one corporation, is called the "unitary method" of apportionment and is used by most states which have a corporate income tax. *The proposed treaty does not affect the application of this method when applied to a single corporation.* S. Rep. No. 18, 95th Cong., 1st Session, *reprinted in* 1980-1 C.B. 411, 420 (emphasis supplied).

The same report added that, despite the limitations on California-style combined reporting in the proposed treaty, a state "may take into account the income and assets of any other branches of [a British] corporation, wherever located, because a corporation is considered to be a single enterprise regardless of how many separate branches or businesses it has." *Id.* at 420.

Representatives of the Executive branch made equally clear that New York's (and most other states') approach to taxation would survive the Treaty. The Assistant Secretary of the Treasury, testifying before the Foreign Relations Committee, noted that even states affected by the proposed prohibition on combined reporting may "take into account . . . income of U.K. Companies doing business in" those states. *Treaty Hearings*, Prepared Statement of Ass't Secretary of the Treasury Laurence N. Woodworth ("Woodworth Statement"), *reprinted in* 1980-1 C.B. 439. Similarly, the Treasury Department's "Technical Explanation" of the

treaty noted simply that, whatever other restrictions proposed Article 9(4) might impose on states, "[b]ecause a corporation is considered a single enterprise regardless of how many branches it has, a State may take into account the income and assets of all branches of that corporation, wherever located." Treasury Department Technical Explanation of the Convention, *reprinted in* 1980-1 C.B. 455, 462.

Thus, the Court of Appeals correctly concluded that Reuters' "argument that the Treaty's drafters intended Article 24(2) as an indirect curtailment on the open and widespread use of worldwide income apportionment methods strains credulity and proper interpretation." The American legislative history makes entirely clear that both the Executive branch that negotiated the treaty and the Senators who ultimately ratified it believed that it did not prohibit states from taxing corporate branches on the basis of worldwide income. There is absolutely no legislative history supporting petitioner's side of the argument.

The ultimate fate of Article 9(4) further demonstrates the validity of respondents' position. Senators of states unwilling to deny themselves the option of using worldwide combined reporting prevented the Senate from producing enough votes to ratify the Treaty as proposed. The failure of the Senate to ratify the Treaty as originally proposed forced the inclusion of a Third Protocol to the Treaty, applying the prohibition on combined reporting to the United Kingdom and the United States but not to the individual states. Third Protocol Further Amending The Convention, *reprinted in* 1980-1 C.B. 409, 410. A subsequent Senate Report made explicit the fact that "the protocol makes Article 9(4) of the proposed treaty, which restricts the use of the worldwide combination/unitary method of apportioning income, inapplicable to state or local governments." S. Rep. No. 5, 96th Cong., 1st Sess., *reprinted in* 1980-1 C.B. 440, 441. Petitioner's argument thus requires the conclusion that, although the Treaty authorizes (or at least refuses to forbid) a state to include, in the

income of a British corporation doing business there, the income of affiliated, subsidiary or parent corporations regardless of where they do business, it also prohibits a state that does not consider the income of those related corporations from taking into account the worldwide income of the very corporation whose branch is found in the state. Such a result defies logic. And indeed, in the years since ratification of the Treaty, political pressure brought by alien corporations has led every state that once employed worldwide combined reporting to change its practice and exclude from state tax the income of alien corporations not doing business in the United States, even when these corporations are affiliated with an alien corporation that is taxable in the state. *See*, J. Hellerstein & W. Hellerstein, State Taxation ¶ 8.16 (1992); Note, *Desperate for Revenue: The States' Unconstitutional Use of the Unitary Method to Apportion the Taxable Income of Foreign Parent Corporations*, 19 Hastings Const L.Q. 1077 (1992). Yet every single one of these states continues to tax the branch of a foreign corporation on the basis of the corporation's worldwide income.

As the Court of Appeals noted, petitioner also overlooks a different treaty provision whose presence is fatal to its argument. Article 7(2) states that

> [t]he profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

If this provision, which applies only to the United States,[6] applied to the states as well, then petitioner would of course prevail, for it prohibits exactly the approach to corporate profits that New York takes. As it is, however, the provision lends support to respondent's argument. If the treaty were in fact designed to forestall state taxation on the basis of worldwide profits, the obvious, simple and logical means of effecting such a prohibition would be directly via this Article rather than obliquely via the ambiguities of the nondiscrimination clause. The Treaty is, however, as the Court of Appeals said, "tellingly silent in that regard" (8a). The plain conclusion is that the Treaty does not attempt to limit the states in this fashion.

Both Article 7(2) and Article 24(2), as well as many other treaty provisions, were taken verbatim from the Model Convention. As petitioner correctly observes (Br p 13, n 13), the Commentaries to this Model Convention are an important guide to the meaning of the United States tax treaties derived from it. In the case at bar, not only the Commentaries but also the Model Convention itself provide support for respondent's case.

Most significantly, the Commentaries confirm that New York's treatment of Reuters' New York branch as a part of Reuters Limited, with no separate legal identity of its own, is correct. The Commentaries note succinctly "the actual nature of the permanent establishment, which is not a separate legal entity but only a part of an enterprise that has its head office in another State." Model Convention at 166. There could not be a more conclusive refutation of Reuters' contention, which is critical to its entire case, that a branch is "a separate entity" from the corporation of which it is part.

[6]Except for the Non-Discrimination Article, which applies "to taxes of every kind and description imposed by each contracting State, or by its political subdivision or local authorities," Art. 2(4), the US-UK treaty applies only to "taxes on income imposed by each contracting State," Art. 2(1)—that is, to federal tax only.

Petitioner also overlooks a Model Convention provision that shows the validity of New York's method. Article 7(4) of the Model Convention provides that

> [i]nsofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary. . . .

This paragraph permits, insofar as it is "customary," exactly what New York does: an apportionment of the total profits of a foreign corporation to a branch doing business in a contracting state. The absence of this provision from the US-UK Treaty is not relevant, for it would not in any case apply to the states. But its presence in the Model Convention is deeply significant. If, in the view of the framers of the Model Convention, the approach it envisions truly conflicted with the nondiscrimination clause, it presumably would not be part of the Convention. This is especially true because, as one scholar notes, Article 24(2)[7] simply gives effect to whichever provision of Article 7 is found in the treaty, in that "it presupposes that the taxation of the permanent establishment will be limited in cause and amount as provided for by Article 7," which in turn "determines the framework within which" Article 24(2) applies. K. Vogel, *et al.*, *Klaus Vogel on Double Taxation Conventions* (1991) 1132. At the very least, one would expect the Commentary somehow to grapple with the supposed conflict. But the Commentary is silent on the subject,

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[7]The permanent establishment non-discrimination provision, which is Article 24(2) in both the US-UK Treaty and the 1977 Model Convention, appears as Article 24(3) in the 1992 edition of the Model Convention.

strongly suggesting that the approach envisioned by Article 7(4) simply does not discriminate against foreign corporations.

Petitioner's own effort (Petition, p 14) to rely on the Model Convention is marred by its selective and elliptical quotation of the Commentaries to that document. Reuters heavily edits and elides two distinct passages, the first of which states that "[s]trictly speaking, the type of discrimination which [the nondiscrimination provision] is designed to end is discrimination based not on nationality but on the actual situs of an enterprise." Model Convention at 165. To petitioner, this somehow shows that "the purpose of Article 24(2) is to permit foreign taxpayers to compete in local markets with no greater total tax expense than local businesses in the same market." Reuters, however, overlooks the simple and obvious meaning of this language, elucidated in the sentence that follows it (and concludes the section in which it appears) in the Commentaries but that Reuters does not quote: the nondiscrimination clause "therefore affects without distinction, and irrespective of their nationality, all residents of a Contracting State who have a permanent establishment in the other Contracting State." *Id.* In other words, the important factor is the situs of a corporation, not its nationality. This is hardly pertinent to the present case.

Thus, the US-UK Treaty itself, its legislative history and the Model Convention on which it is based offer unqualified support for the unanimous conclusion of four different tribunals that the nondiscrimination clause of the treaty (as well as the identical or similar clauses found in many other treaties) does not prohibit New York's consideration of the worldwide income of a corporation doing business in the State through a branch.

Reuters' contention (Petition, pp 15-17) that the Court of Appeals' interpretation of the nondiscrimination clause "is contrary to that of the contracting states" is likewise without merit. Petitioner first contends that the United States Treasury Department

has found that the nondiscrimination clause of the model treaty "require[s] that the permanent establishment be treated as if it were a domestic subsidiary—instead of a branch—of the foreign corporation of which it is a part." This mischaracterizes the pronouncement in question. I.R.S. Notice 89-80, 1989-2 C.B. 394, deals with the tax imposed by IRC § 884(f)(1)(B) on the "excess interest" of a United States branch of a foreign corporation. As this tax has been explained elsewhere,

> [u]nder the United States tax system applicable to a branch of a foreign corporation, the branch may deduct a portion of the interest paid by the foreign corporation "parent." This portion is determined by a formula which allocates the entire interest paid by the corporation among all its branches and its head office according to the assets attributable to each. If the amount apportioned to the United States branch, and therefore deductible by it, exceeds the interest actually paid by the branch (the "excess interest"), this excess is treated as interest paid by the United States branch to the head office [and is taxable as such].

J. Jones, H. Depret, M. Van De Wiele, M. Ellis, K. Van Rand, P. Fontuneau, R. Lenz, H. Torrione, T. Magney, T. Miyatake, S. Roberts, S. Goldberg, J. Strobl, J. Killius, V. Uckmar, G. Maisto & D. Ward, *The Non-Discrimination Article in Tax Treaties—Part II*, *British Tax Review*, Nov.-Dec. 1991, 421, 428.

In the Treasury Department's view, this tax, although not also imposed on United States corporations, is not discriminatory because "excess interest with respect to a branch is the functional equivalent of interest paid on parent debt funding with respect to a subsidiary." 1989-2 C.B. at 397. In other words, the I.R.S. treats "a foreign corporation's excess interest as if it were interest on a loan from the foreign corporation to its wholly-owned domestic subsidiary" not because it wishes to treat the branch as if

it were a subsidiary, but because it recognizes that the benefit that accrues to the foreign corporation by virtue of its branch's "excess interest" is equivalent to the benefit that would accrue to the same corporation had it been a parent loaning money to a domestic subsidiary. *Id.* The relevant comparison is between one corporation and another corporation, not between a corporation and a branch viewed (in petitioner's terms) as "a separate entity."

Petitioner's claim that the Appellate Division's holding is "flatly contrary" to the interpretation of the Treaty offered by the U.K. Board of Inland Revenue is also incorrect, resting as it does on a bold mischaracterization of its supposed source. Petitioner relies for this contention on a 1978 letter to the British Tax Review from one J.D.B. Oliver, who had the year before published in that journal an article on the nondiscrimination provisions of the Model Treaty, covering both the permanent establishment nondiscrimination provision and other portions of the nondiscrimination article. *See*, J. Oliver, *Discrimination*, 3 British Tax Review 148 (1977). He then published a short follow-up article in the same journal, suggesting that the Inland Revenue had changed its view as to the scope of the portion of the nondiscrimination provision dealing not with permanent establishments but with the treatment of foreign-controlled groups of companies.[8] *See*, J. Oliver, *Discrimination*, 3 British Tax Review 324 (1977). In response to this latter article, Oliver professed subsequently to have "received a letter from the Inland Revenue" indicating that Oliver's apparent belief, to the effect "that where a U.K. subsidiary of a non-resident company was involved a proper comparison would be with a U.K. subsidiary of a U.K. parent company," was "not [a] correct" interpretation of "paragraph 6 [of Article 24] of the 1977 Model Convention." J. Oliver,

[8]Paragraph 6 of Article 24 of the Model Convention (Paragraph 5 in the 1992 edition) deals with taxation on "Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State."

Discrimination, 4 British Tax Review 198 (1978). Rather, the Inland Revenue said, its "position is more correctly summarized in" Oliver's 1977 discussion of this particular paragraph. *Id.* Since the exchange between Oliver and the Inland Revenue dealt with subsidiaries rather than permanent establishments, and involved paragraph 6 of Article 24 of the Model Convention rather than paragraph 4, it has no application to the present case.

Thus, neither the United States nor the United Kingdom taxing authorities have taken a position on the nondiscrimination provision that conflicts with the decision of the Court of Appeals. There is likewise no conflict between that decision and the two foreign decisions discussed by Reuters (Petition, pp. 17-20). In the French *Judgment of November 18, 1985*, Conseil D'Etat (62a), the issue was the treatment of dividends paid by a subsidiary to a French branch of an Italian corporation. The question was whether the relevant comparison under the nondiscrimination clause was between a French corporation and the French branch or between a French corporation and the Italian corporation. That the French court used the branch as the point of comparison is scarcely relevant to this case. The Commentaries to the OECD Model Treaty include a lengthy discussion of this highly specialized problem, entitled "Special Treatment of Dividends Received in Respect of Holdings Owned by Permanent Establishments." Model Convention 167-69.[9] This discussion characterizes the approach taken by the French court as "special treatment . . . accorded to permanent establishments," and notes that "opinions differ" on the point, with some nations doing what France did and others taking the opposite position. If the Model Treaty envisions that either approach complies with the nondiscrimination clause, then Reuters cannot rely on the fact that a particular French court adopted a view more favorable to its position.

[9]Article 24(2) of the US-UK Treaty is identical to Article 24(4) of the Model Convention.

The German decision in *Judgment of March 30, 1973*, Finanzgerichte in Dusseldorf (57a) is of even less assistance to petitioner. In this case, involving the German branch of a Japanese corporation, the German court appears not to have used the approach taken by either petitioner or the courts below in this case. Rather, it held that "[w]hat type of legal form the domestic companies to be compared must have, depends on the legal form of the Japanese corporation. This legal form must be ascribed to the nonindependent permanent establishment within the meaning of" the Nondiscrimination Clause (59a). In other words, the German court *first* concluded that the activities of the German branch strongly resembled those of its Japanese parent, and *then* compared the Japanese corporation to its German corporate counterpart. This two-step approach is not supported by the Treaty, is not what petitioner elsewhere urges and in fact would not help petitioner if it were adopted.

Petitioner cannot, finally, rely, as it attempts to (Petition, pp 21-23), on its alleged costs of compliance with New York law to urge that the State discriminates against Reuters as compared with a New York corporation. Petitioner tries to make much of the fact that its employee's testimony as to its supposedly extravagant compliance costs was "unrefuted," "uncontroverted" and "undisputed." But all this means is that it was not directly rebutted by oral testimony at the hearing—as, indeed, how could it have been? At the time of the hearing, Canty had "no idea" what Reuters' compliance costs would be. Only five months later did he submit an affidavit containing his specific claims. At that point, the Division of Taxation could conceivably have moved to reopen the hearing and then subpoenaed Reuters' employees in the hope that at least one would risk his or her job in order to expose the baselessness of Canty's statements. This roundabout and wasteful approach, however, was unnecessary, for Canty's testimony was not "unrefuted." If a witness states in an affidavit that the sun rises in the west, there is no need to introduce contradictory testimony to "refute" his contention. The claim,

like petitioner's, is self-evidently dubious. Reuters has been doing business through a branch in New York since 1916, and New York has been imposing franchise tax on the basis of a foreign corporation's allocated worldwide income since 1917. Thus, for sixty years prior to the tax years now at issue, Reuters somehow managed to comply with the supposedly discriminatory requirements of New York's franchise tax methodology. Any "start-up" costs of compliance had long since been incurred, and any annual costs had for many decades been absorbed as part of the cost of doing business. Indeed, petitioner's original 1977 tax return, as prepared by Coopers and Lybrand, complied in every relevant respect with the Franchise Tax Law. Petitioner, however, offered no testimony as to its actual costs of compliance in 1977, preferring to speculate as to what its costs might be in the future.

Moreover, Reuters managed to provide the Audit Division with worldwide net profit data only thirteen days after a meeting between Reuters personnel and a Tax Department conferee made clear the need for this information. The alacrity of petitioner's response hardly suggests the prohibitive compliance costs it now claims. In addition, as Canty noted at the hearing, as a U.K. resident company, Reuters is "subject to U.K tax on all its activities no matter where in the world they are carried out" (R130). In other words, the very information which petitioner claims can be gathered for the purposes of New York tax only at an onerous cost must routinely be compiled for petitioner to pay its British tax. Yet according to Reuters its annual costs of "converting" its accounts to a tax system it has observed since World War I will be $1 million, and threaten to "destroy" it. In view of the foregoing, the New York courts' characterization of Reuters' alleged compliance costs as "sorely undermined" by the remainder of the record seems understated and gentle.

Thus, as the Court of Appeals concluded, Reuters' stillborn efforts to demonstrate its excessive costs of compliance with New York's franchise tax methodology simply did not entitle it to

a resolution of the legal issues it attempted to raise. But even if Reuters' claims about compliance costs are taken at face value, that is not enough to show "discrimination" against British companies under the Treaty. Much of the testimony in support of the original treaty's prohibition on California-style worldwide combined reporting focused on the administrative costs of that method, *see generally, Treaty Hearings*, a fact that was fully noted in Executive-branch comments in support of the original treaty. *See*, Letter of Submittal by Department of State to President, June 8, 1976, *reprinted in* 1980-1 C.B. 431, 432 (combined reporting, "which includes the burden of producing worldwide records of all the affiliated companies, has raised many objections by our treaty partners . . ."); Woodworth Statement, 1980-1 C.B. at 438 ("We also perceive a major problem in the extensive information required by the tax authorities applying unitary apportionment systems.") Yet the Senate refused to prohibit the States from employing this method, which requires that an alien corporate taxpayer report not only the income of all its branches worldwide but also the income of its parent, subsidiary and affiliated corporations. If the administrative costs for foreign corporations required to make combined reports were acknowledged by the Senate but were insufficient for ratification of the Treaty as originally proposed, then obviously the far smaller costs imposed by the Franchise Tax do not amount to discrimination against alien corporations under the Treaty.

Reuters' entire case is built on nothing more than a slight grammatical ambiguity in the nondiscrimination provision of the US-UK Treaty. The language of this treaty itself, however, warrants New York's application of its franchise tax to British corporations which, like Reuters, do business in New York through a branch. The legislative history of the treaty provides overwhelming support for the view that both the Senate and the Executive Branch intended that the approach to taxation of foreign corporations taken by New York and virtually every other state continue after passage of the treaty. Nor does the view of the non-

discrimination provision taken by the New York State Department of Taxation and Finance conflict in any way with the interpretations offered by the contracting governments or by foreign courts. In the course of this case's progress through the New York State administrative and judicial system, four different tribunals have unanimously rejected Reuters' claims, variously recognizing that its legal argument "strains credulity" and its factual assertions are "greatly exaggerated." The interpretation on which Reuters insists is simply impossible, for it requires belief that the Senate intended to invalidate the method by which virtually every state has for decades calculated corporate income tax, even as the Senate, the Treasury Department and the leading British business organization were giving assurances throughout the ratification process that precisely the opposite was the case. There is no reason for this Court to grant Reuters' petition merely to restate the inevitable conclusion reached by the courts below.

II.

Reuters has not shown that it incurs unusual or extraordinary costs in complying with the New York Franchise Tax Law, and thus cannot contend that its burden of compliance violates the Foreign Commerce Clause.

As noted in the preceding section, the New York courts understood the baselessness of Reuters' extravagant claims as to its costs of compliance with the New York Franchise Tax Law, recognizing that these contentions were "sorely undermined" by the factual circumstances of the case. For this reason, the Court of Appeals correctly declined to "speculate on whether the cost of complying with New York's tax methodology unconstitutionally burdens foreign commerce." There is no reason for this Court to reexamine this conclusion.

It is in any event dubious whether such a claim can ever succeed. As this Court has noted, the cost of compliance with a state regulation cannot alone support a holding that state law "unduly burden[s] interstate commerce." *Bibb v Navajo Freight Lines*, 359 US 520, 526 (1959). This Court has recently granted certiorari in a case in which a California court held, *inter alia*, that the costs incurred by a foreign-based multinational enterprise in complying with California's worldwide combined reporting requirements did not amount to an unconstitutional discrimination under the Foreign Commerce Clause. *See, Barclays Bank v Franchise Tax Board*, 10 Cal App 4th 1742 (1992), *cert. granted*, ____ US ____, 114 S Ct 379 (1993). This Court's decision in *Barclays* will presumably indicate whether compliance costs can ever amount to an unconstitutional discrimination against foreign commerce and, if so, whether they did so for the taxpayer involved in that particular case. But a prerequisite to such a claim is that the taxpayer make a plausible showing of excessive compliance costs. Reuters—which asks the Court to believe that it will incur extraordinary "start-up" expenses and undertake unusual expenses for the "changes" and "adjustments" it supposedly must make in order to "comply" now with a statute with which it has been complying since 1917—has not made such a showing. Consequently, there is no reason for this Court to grant the petition in order to engage in constitutional speculation that is unwarranted by the facts of this case.

III.

The decision of the Court of Appeals does not conflict with this court's decision in *Kraft General Foods*.

Relying exclusively on the readily-distinguishable case of *Kraft General Foods, Inc. v Iowa Department of Revenue and Finance*, ____ US ____, 112 S Ct 2365 (1992), petitioner (Petition pp. 23-25) mistakenly contends that the New York franchise tax is facially unconstitutional as a discrimination against foreign commerce.

Kraft examined a methodology whereby Iowa taxed dividends paid by a foreign subsidiary of a domestic parent corporation, but did not tax dividends paid by a domestic subsidiary to the same parent. This Court deemed the practice a facial violation of the foreign commerce clause's prohibition against discrimination, for Iowa "imposes a burden on foreign subsidiaries that it does not impose on domestic subsidiaries." 112 S Ct at 2371. New York, however, engages in no such discrimination. In the case of both foreign and (non-New York) domestic corporations with New York branches, New York requires reporting of worldwide income, which is then apportioned according to the established three-factor formula that was upheld in *Bass*, *Ratcliff* and that Reuters does not challenge. The Court of Appeals recognized that there is no discrimination in such an approach, and there is no reason for this Court to examine that unexceptionable conclusion now.

CONCLUSION

The Petition for a Writ of Certiorari should be denied.

Dated: Albany, New York
February 9, 1994

Respectfully submitted,

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